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Secured Transactions— Real Property

by *Marshall Cornblum**

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I. Introduction

As in most fields of the law, the law pertaining to real property security transactions is continually evolving.¹ That evolving process is highlighted by the current trend of the California Supreme Court allowing the parties, at the inception of their transaction, to freely elect the true nature of the transaction, and thereafter be bound by that election. At the inception of a security transaction, the true nature of that transaction is limited only by the imagination and relative bargaining positions of the parties. In determining this true nature, the court will look to substance rather than form. Once the true nature is established, the rights, duties, and obligations of the parties are determined by the applicable law.

1. For a thorough and complete review and analysis of California real property security transactions, see Hetland, *California Real Estate Secured Transactions*, Cal. C.E.B. (1970).

II. Antideficiency Legislation

A. In General

The prohibition or limitation on the personal liability of a debtor in a real property security transaction is determined by applying the provisions of Code of Civil Procedure sections 580b,² 580d,³ and 726⁴ to the facts of each particular case.⁵

2. Code of Civ. Proc. section 580b provides as follows:

“No deficiency judgment shall lie in any event after any sale of real property for failure of the purchaser to complete his contract of sale, or under a deed of trust, or mortgage, given *to the vendor to secure payment of the balance of the purchase price of real property, or under a deed of trust, or mortgage, on a dwelling for not more than four families given to a lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of such dwelling occupied, entirely or in part, by the purchaser.*” (Italicized portions added by 1963 amendment.)

3. Code of Civ. Proc. section 580d provides, in part:

“No judgment shall be rendered for any deficiency upon a note secured by a deed of trust or mortgage upon real property hereafter executed in any case in which the real property has been sold by the mortgagee or trustee under power of sale contained in such mortgage or deed of trust.”

4. Code of Civ. Proc. section 726 provides in part:

“There can be but one form of action for the recovery of any debt, or the enforcement of any right secured by mortgage upon real property, which action must be in accordance with the provisions of this chapter The decree for the foreclosure of a mortgage or deed of trust secured by real property or any interest therein shall declare

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the amount of the indebtedness or right so secured and, unless judgment for any deficiency there may be between the sale price and the amount due with costs is waived by the judgment creditor or a deficiency judgment is prohibited by Section 580b, shall determine the personal liability of any defendant for the payment of the debt secured by such mortgage or deed of trust and shall name such defendants against whom a deficiency judgment may be ordered following the proceedings hereinafter prescribed. In the event of such waiver, or if the prohibition of Section 580b is applicable the decree shall so declare and there shall be no judgment for a deficiency. In the event that a deficiency is not waived or prohibited and it is decreed that any defendant is personally liable for such debt, then upon application of the plaintiff filed at any time within three months of the date of the foreclosure sale and after a hearing thereon at which the court shall take evidence and at which hearing either party may present evidence as to the fair value of the property or the interest therein sold as of the date of sale, the court shall render a money judgment against such defendant or defendants for the amount by which the amount of the indebtedness with interest and costs of sale and of action exceeds the fair value of the property or interest therein sold as of the date of sale; provided, however, that in no event shall the amount of said judgment, exclusive of interest from the date of sale and of costs exceed the

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B. *Purchase Money Antideficiency Protection: Code of Civil Procedure Section 580b*

Prior to the 1963 amendment to Code of Civil Procedure section 580b, the identity of the person furnishing the "purchase money" was immaterial.⁶ No distinction was made between a vendor and a third-party lender. In either case, the person furnishing all or any part of the purchase price and taking a note secured by a deed of trust, mortgage, or contract of sale on the purchased property could not get a deficiency judgment against the purchaser.

With the enactment of the 1963 amendment to section 580b, the identity of the person furnishing the purchase money became material, as did the character of the purchased property. Section 580b, as it now reads, does not change the result as to a lender of purchase money for residential property as defined by section 580b or as to a vendor. However, all other third-party lenders are not subject to the provisions of section 580b.

1. *Distinction Between Lender and Vendor*

In *Kistler v. Vasi*,⁷ the plaintiffs were real estate brokers who took a note from the defendants in 1965, as part of their commission. The note was secured by a second deed of trust on the unimproved property purchased by the defendants. A sale under the first deed of trust wiped out the plaintiffs' security, and they commenced this action to recover on the note. The Court held that plaintiffs were "lenders" under the amended section 580b, and were therefore not precluded from recovering a deficiency judgment.

difference between the amount for which the property was sold and the entire amount of the indebtedness secured by said mortgage or deed of trust"

5. Code of Civ. Proc. section 580a, allowing deficiency judgments following sale under the power contained in a deed of trust, is no longer effective in light of Code of Civ. Proc. section

580d. See also *Roseleaf Corp. v. Chierighino*, 59 Cal.2d 35, 27 Cal. Rptr. 873, 378 P.2d 97 (1963).

6. *Bargioni v. Hill*, 59 Cal.2d 121, 28 Cal. Rptr. 321, 378 P.2d 593 (1963).

7. 71 Cal.2d —, 78 Cal. Rptr. 170, 455 P.2d 106 (1969). For a further discussion of this case, see *Bernhardt, REAL PROPERTY, and YORK, REMEDIES*, in this volume.

This case is important not only for the actual decision, but also for establishing the framework in which to analyze the applicability of section 580b. The Court stated as follows.⁸

[U]nder the plain language of the 1963 amendment to section 580b plaintiffs are lenders and not vendors. The amendment expressly distinguishes between lenders of purchase money and vendors and contemplates that the parties to a sale of real property, other than the defined residential property, may freely elect to arrange for the financing of the purchase price in ways that may wholly or in part limit the vendee's protection from deficiency judgments. If the parties wish to afford full protection to the vendee, they may provide that all security instruments be given to the vendor, in which case subsequent assignees from the vendor would take subject to section 580b. If the vendor is not willing to accept such extensive risks, however, he may insist that all or part of the purchase price be financed by third parties, whose remedies are not affected by section 580b. Moreover, in such a case it is immaterial whether the third party who assists in the financing makes a payment of part of the price to the vendor in exchange for the vendee's note and deed of trust or, as in this case, discharges an existing obligation of the vendor in exchange for the vendee's note and deed of trust.⁹

Two months prior to the California Supreme Court decision in *Kistler v. Vasi*, the Court of Appeals decided *Jackson v. Taylor*.¹⁰ Here again, the issue before the Court was whether a sold-out junior was a "vendor" or "lender" within the amended section 580b. In *Jackson*, the plaintiffs, in 1961, sold unimproved real property to Rodens, and, as part of the purchase

8. 71 Cal.2d —, —, 78 Cal. Rptr. 170, 171–172, 455 P.2d 106, 107–108.

9. Suppose the real estate brokers in *Kistler* had previously assigned their note and deed of trust to the vendors of the property, who then commenced the action against the vendee. Would sec-

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tion 580b then preclude a deficiency judgment?

10. 272 Cal App.2d 1, 76 Cal. Rptr. 891 (1969). For a further discussion of this case, see Rohwer, CONTRACTS, in this volume.

price, took back a note and deed of trust on the purchased property. The deed of trust was subsequently subordinated when Rodens constructed seven rental dwelling units on the purchased property. In 1965, Rodens sold the property to the defendants, and, as part of the transaction, plaintiffs surrendered the Rodens' note and deed of trust in return for a new note from the defendants secured by a second deed of trust on the same property. A sale under the first deed of trust wiped out the plaintiffs' security, and they instituted this action on the note. The Court held that plaintiffs were "vendors" as to the defendants, and thereby were precluded from recovering a deficiency judgment. The Court stated:

When the 1965 transaction involved herein is analyzed, it is clear that, even though the Rodens were the legal owners of the property, plaintiffs also were necessary parties in the transfer of the property to defendants and that, by consenting to, and participating in the sale of the property to defendants, plaintiffs were *vendors* of their interest as beneficiaries under the original trust deed. Moreover, it is clear that the 1965 note and trust deed were given by defendants to plaintiffs as 'a necessary part of the purchase price of the property'. For these reasons we must conclude that plaintiffs were *vendors* with respect to the 1965 purchase which brings the 1965 note and trust deed within provisions of section 580b as amended.¹¹

Jackson cannot be reconciled with *Kistler*. In *Jackson*, the plaintiffs were "vendors" of the property as to Rodens, but not as to defendants. Under *Kistler*, the applicability of section 580b is determined by its "plain language." If section 580b were intended to preclude a prior vendor from obtaining a deficiency judgment against a subsequent purchaser, the statute would have read "to a vendor" and not, as actually written, "to the vendor." Also, the reference to "vendor" under section 580b must, of necessity, refer to a seller of real

11. 272 Cal. App.2d 1, 6-7, 76 Cal. Rptr. 891, 894-895.

property. The holder of a beneficial interest under a deed of trust holds personal property and not real property.

Under the amended section 580b, the relationship of the parties, each as to the other, must be analyzed. For example, if A sells nonresidential property to B, and, as part of the purchase price, A takes back a promissory note secured by a deed of trust on the purchased property, A is a “vendor” as to B. However, if B then sells the property to C, who either assumes A’s note and deed of trust or issues a new note and deed of trust to A, A would be a “lender” as to C.

*Kincaid v. Gomez*¹² demonstrates that the Court will look to the substance of the transaction in determining the applicability of section 580b. In this case, plaintiff agreed to sell real property to “Gomez and/or Nominee,” and take back, as part of the purchase price, a note secured by a second deed of trust on the purchased property. Title to the property was taken by the nominee, Dolphin Construction Company. A note was signed by Gomez, Magliocco, and Dolphin Construction Company. Dolphin executed the deed of trust securing the note. A sale under the first deed of trust wiped out plaintiff’s security. Plaintiff, being a sold-out junior, then sued Gomez and Magliocco to recover on the note. It was stipulated at trial that Gomez and Magliocco were the actual purchasers of the property. The Court held that plaintiff was a “vendor” and that section 580b, therefore, precluded him from obtaining a deficiency judgment against Gomez and Magliocco. It was argued that section 580b was inapplicable, since Gomez and Magliocco did not execute the deed of trust, but the Court rejected the argument, stating:

The fact that the deed of trust was executed by the corporation only, for it alone held title, does not mean that the note was unsecured on respondents’ part, thereby rendering them liable to a personal judgment. Taking the transaction as a whole, and considering that it was contemplated from the beginning that there would be a

12. 274 Cal. App.2d —, 79 Cal. Rptr. 539 (1969). For a further discussion of this case, see Bernhardt, REAL PROPERTY, and YORK, REMEDIES, in this volume.

nominee, that Dolphin Construction Company was the sole nominee, and that the note expressly says that it is secured by a deed of trust, we regard the transaction, as the trial judge did, as a single one.¹³

2. "Sold-Out Junior"¹⁴

In 1953, *Brown v. Jensen*¹⁵ held that section 580b precluded a sold-out junior of purchase-money security from obtaining a deficiency judgment. Subsequently, in 1963, *Roseleaf Corp. v. Chierighino* and *Bargioni v. Hill* left reason to believe that *Brown v. Jensen* was no longer the law with respect to sold-out juniors of purchase-money security.¹⁶

Kistler has apparently reaffirmed *Brown v. Jensen*. *Kistler* not only cited *Brown* favorably, but it observed that if the parties had chosen another method for the payment of plaintiffs' commission, the defendants would have been afforded the protection of section 580b. Since the most likely alternative method would have been for the defendants to give a note and deed of trust to the vendors, who in turn would have assigned it to the plaintiffs, and since the plaintiffs were, in fact, sold-out juniors, the reasoning is that a sold-out junior would still be precluded by section 580b from recovering a deficiency judgment.

California Court of Appeals decisions in *Kincaid v. Gomez*, supra, and *Jackson v. Taylor*, supra, have held that section 580b bars a sold-out junior of purchase-money security from obtaining a deficiency judgment.

3. What Constitutes the "Purchase Price"?

In *Pond v. Schwartz*,¹⁷ the defendant conveyed an undivided one-half interest in real property to the plaintiffs. The plain-

13. 274 Cal. App.2d —, —, 79 Cal. Rptr. 539, 540-541.

14. A "sold-out junior" is the holder of a junior deed of trust or mortgage whose security has been wiped out by a judicial or nonjudicial sale under a senior deed of trust or mortgage.

15. 41 Cal.2d 193, 259 P.2d 425 (1953).

16. See Hetland, *Deficiency Judgment Limitations in California—A New Judicial Approach*, 51 Cal. L. Rev. 1 at 11 (1963).

17. 268 Cal. App.2d 572, 74 Cal. Rptr. 353 (1968).

tiffs agreed (1) to execute a \$30,000 note secured by a deed of trust on the purchased undivided one-half interest and (2) that their undivided one-half interest in the property “is to be deemed security for any losses suffered” by defendant in an unrelated transaction. The Court affirmed the trial court’s holding that the agreement between the parties was that the “purchase price” was \$30,000 plus the loss suffered by the defendant in the unrelated transaction, and that the defendant was precluded by section 580b from obtaining a deficiency judgment against the plaintiffs.¹⁸

The Court’s conclusion in *Pond* that the two obligations (one of which carried no promise to pay) constituted the “purchase price” for the undivided one-half interest demonstrates the amount of care that must be taken in setting up any such transaction to avoid having the “purchase price” include more than the parties anticipate.

III. Guarantors and Sureties

In situations involving a guarantor of a secured obligation, the analysis of any particular transaction will encompass one or more of the following areas: (a) The nature and extent of the guaranty; (b) The rights, duties, and obligations of the guarantor and of the secured creditor, as to each other; (c) Whether the guarantor has waived, or is estopped from asserting, his rights against the secured creditor; (d) The rights, duties, and obligations of the guarantor and of the secured debtor, as to each other; and (e) The effect of the antideficiency legislation.

18. The purchase agreement in question was executed on June 23, 1960, and when the Court referred to the applicability of section 580b, 268 Cal. App.2d 572, 580, 74 Cal. Rptr. 353, 358, it sets forth section 580b, as amended in 1963. Inasmuch as the same result would follow under section 580b before it was amended, the refer-

ence to the amended section 580b is probably an oversight by the Court, and should not be relied on as indicating the amendment to be retroactive. See Civ. Code section 3 and Code of Civ. Proc. section 3, stating that provisions of codes are not retroactive unless expressly so declared.

A. Nature and Extent of the Guaranty

In *Roberts v. Graves*,¹⁹ Meadowbrook Developers, Inc. purchased real property from Roberts, and, as part of the purchase price, executed a \$33,000 promissory note secured by a second deed of trust on the purchased property. Graves signed the note "individually and as Co-guarantor." Extrinsic evidence, developed at the trial, showed that Graves knew Roberts would be hypothecating the note and deed of trust to a bank in order to borrow \$16,500, and that the bank would not make the loan to Roberts unless Graves personally guaranteed the purchase-money note. A sale under the first deed of trust wiped out the security of Roberts, who then commenced this action against Graves as a guarantor. The Court held that Graves only guaranteed the note to the extent of the \$16,500 borrowed from the bank, and further held that section 580b does not protect a guarantor of purchase-money security.

A "dragnet" or "omnibus" clause in a guaranty agreement provides that the guaranty encompasses all sums of money that the creditor has previously loaned, or that the creditor subsequently loans, to the debtor. A similar clause in a deed of trust provides that the deed of trust is given to secure the payment of all moneys now and hereafter due or owing from the trustor to the beneficiary.

In *Beverly Hills Nat. Bank v. Glynn*,²⁰ defendant Glynn, an attorney experienced in financial affairs, executed a guaranty containing a "dragnet" clause in favor of the bank. Prior to the execution of the guaranty, the bank had made two loans to the debtor. The bank sued Glynn on the guaranty for the amount of the two earlier loans. The Court held Glynn liable on the guaranty for the two notes executed by the debtor prior to Glynn's execution of the guaranty, and stated that "the language patently put him on notice that there had been earlier loans."

¹⁹ 269 Cal. App.2d 410, 75 Cal. Rptr. 130 (1969).

²⁰ 267 Cal. App.2d 859, 73 Cal. Rptr. 808 (1968); modified 268 ACA 612, 73 Cal. Rptr. 808.

Beverly Hills Nat. Bank v. Glynn, supra, should be compared with *Gates v. Crocker-Anglo Nat. Bank*,¹ wherein the Court held a dragnet clause in a deed of trust inapplicable to one of the co-trustors for a prior unsecured loan made by the bank to the other co-trustor. The Court reasoned that plaintiff, being totally unaware of the prior unsecured loan, presumably would not have executed the deed of trust had he known that the dragnet clause contained therein would render him liable as a surety for his cotenant's individual debt.

In essence, the *Beverly Hills Nat. Bank v. Glynn* case holds that a dragnet clause imparts at least constructive notice to the guarantor of the existence of prior loans, whereas the *Gates v. Crocker-Anglo Nat. Bank* case holds to the contrary. Because of the differing approaches used by the Courts in analyzing the applicability of dragnet clauses, the creditor should tell the guarantor or co-trustor of any prior loans it made to the debtor, and, correspondingly the guarantor or co-trustor should ask the creditor about the existence of any prior loans made to the debtor.

The dragnet clause raises issues regarding two separate notes or debts secured by a single deed of trust on real property. Issues yet to be decided are:

(1) If the secured creditor holds a sale under the power on only one of the notes, does section 580d preclude a deficiency judgment on the second note, and, if not, does the secured creditor have the uncontrolled discretion as to which note he treats as secured and which note unsecured?

(2) If the secured creditor brings a judicial foreclosure action on one of the notes, does Code of Civil Procedure section 726 limit or preclude a deficiency judgment on the second note, or, if the creditor first obtains a personal judgment on one of the notes, has he then waived his security for the second note, and possibly waived the debt itself?²

1. 257 Cal. App.2d 857, 65 Cal. Rptr. 536 (1968).

2. For discussion on section 580d "note" and section 726 "debt," see Hetland, *Deficiency Judgment Limitations in California—A New Judicial Ap-*

proach, 51 Cal. L. Rev. 1 (1963); see also *Gates v. Schuster*, 227 Cal. App.2d 287, 38 Cal. Rptr. 644 (1964) and *Loretz v. Cal-Coast Dev. Corp.*, 249 Cal. App.2d 176, 57 Cal. Rptr. 188 (1967).

B. Rights, Duties, and Obligations of the Guarantor and of the Secured Creditor, as to Each Other

In *Sumitomo Bank of Cal. v. Iwasaki*,³ the California Supreme Court held that a creditor has a duty to disclose facts it knows about the debtor to the guarantor if (a) the creditor has reason to believe that those facts materially increase the risk beyond that which the guarantor intends to assume, (b) the creditor has reason to believe that the facts are unknown to the guarantor, and (c) the creditor has a reasonable opportunity to communicate the facts to the guarantor. If the guarantor establishes *all* of the above conditions, he will be discharged from liability to the creditor.

In *Union Bank v. Brummell*,⁴ Brummell guaranteed a non-purchase-money secured note to Union Bank. The bank held a nonjudicial sale, bid in less than the secured obligation, and commenced this action to recover the deficiency against Brummell on his guaranty. The Court, relying on *Union Bank v. Gradsky*,⁵ held that the bank, by holding the nonjudicial sale, had exercised an election of remedies that destroyed Brummell's subrogation rights against the principal debtor, and that it was thereby precluded from recovering the deficiency from the guarantor.

Thus, a secured creditor whose obligations are guaranteed has three remedies from which to choose: (1) He may bring a judicial foreclosure action, joining both the debtor and the guarantor; (2) he may sue the guarantor on the guaranty for the full amount of the unpaid balance of the principal obligation without proceeding against the debtor or the security; or (3) he may realize on the security by way of a nonjudicial sale. If the creditor elects to use the nonjudicial sale (*Union Bank v. Brummell*) and thereby terminates the guarantor's rights against either the security or the principal debtor, he will be precluded from recovering the deficiency from the guarantor.

3. 70 Cal.2d 81, 73 Cal. Rptr. 564, 447 P.2d 956 (1968). For a further discussion of this case, see Rohwer, CONTRACTS, in this volume.

4. 269 Cal. App.2d 836, 75 Cal. Rptr. 234 (1969).

5. 265 Cal. App.2d 40, 71 Cal. Rptr. 64 (1968).

The reviewing Courts have not yet decided whether a secured creditor of a purchase-money obligation (as opposed to a nonpurchase-money obligation, as in *Union Bank v. Brummell*), after holding a nonjudicial sale and bidding in less than the full amount of the principal obligation, can proceed against the guarantor for the deficiency. A logical extension of the *Union Bank v. Brummell* decision would seem to preclude the secured creditor from pursuing the guarantor after holding a nonjudicial sale. In a nonpurchase-money situation such as *Union Bank v. Brummell*, the guarantor's subrogation rights would allow him to obtain a deficiency judgment against the debtor if the secured obligation exceeds the fair market value of the secured property on the date of the judicial foreclosure sale, and then only to the amount of the excess.⁶ There was no discussion as to the fair market value of the secured property in *Union Bank v. Brummell*, and, accordingly, it cannot be determined whether a deficiency judgment could have been obtained against the debtor. However, whether a deficiency judgment would lie or not, the guarantor, upon payment to the secured creditor, would have been subrogated to the security. In a situation involving a guarantor of a purchase-money obligation, there would be no possibility of a deficiency judgment, but the guarantor would have a right to be subrogated to the security.

C. Whether Guarantor Has Waived, or Is Estopped From Asserting, His Rights Against the Secured Creditor

In *Wiener v. Van Winkle*,⁷ the Court held that the defendant guarantor could, and did, waive Civil Code section 2845 (right of guarantor to require creditor to proceed against the principal, or to pursue any other remedy in his power that the guarantor cannot himself pursue and that would lighten his burden) and section 2849 (guarantor is entitled to benefit of security held by the creditor).

6. Code of Civ. Proc. § 726.

7. 273 Cal. App.2d —, 78 Cal. Rptr. 761 (1969). For a further discussion

of this case, see McCall, COMMERCIAL TRANSACTIONS, in this volume.

Both *Union Bank v. Grady* and *Union Bank v. Brummell* stated that a guarantor can waive his defense to the creditor's action to recover a deficiency judgment after a nonjudicial sale, but that the defense had not been waived in those particular cases.

D. Effects of Antideficiency Legislation

Roberts v. Graves, supra, held that a guarantor of a purchase-money secured obligation is not entitled to section 580b protection.

IV. Vendor's Lien

Civil Code section 3046, provides that one who sells real property has a vendor's lien thereon, independent of possession, for so much of the price as remains unpaid and unsecured otherwise than by the personal obligation of the buyer.

Civil Code section 3048, provides that a vendor's lien is valid against everyone claiming under the debtor, except a purchaser or encumbrancer in good faith and for value.

In *Valley Vista Land Co. v. Nipomo Water & Sewer Co.*,⁸ Valley Vista conveyed land to Nipomo, and the latter agreed to install certain water and sewer facilities on other land owned by Valley Vista. Nipomo failed to make the installations. Nipomo then executed a deed of trust to its creditors, who took without knowledge of Valley Vista's rights. The Court held that Valley Vista had a vendor's lien (the amount thereof being equal to the fair market value of the land conveyed by Valley Vista, which was presumed to be the value of the services and facilities promised by Nipomo), but that the vendor's lien was not valid against the creditors. It further held that the creditors were encumbrancers in good faith and for value within the meaning of Civil Code section 3048.

The advantage of a vendor's lien is that the vendor can elect to either sue on the unsecured note without any "one form of action" or antideficiency limitations, or, alternatively,

⁸ 266 Cal. App.2d 331, 72 Cal. Rptr. 181 (1968).

can foreclose his vendor's lien.⁹ However, a major drawback to relying on a vendor's lien is that the lien will be invalid as against a subsequent purchaser or encumbrancer for value who takes without actual or constructive notice of the lien. One possible solution to the problem is to record the deposit receipt or agreement of sale, prior to the sale, designating therein that the seller is taking an unsecured promissory note from the buyer as part of the purchase price (being careful not to inadvertently create a mortgage by the use of any security language). This should preclude any subsequent purchaser or encumbrancer from claiming "good faith" because constructive knowledge of the vendor's lien will be imparted to him due to the recordation of the deposit receipt or agreement of sale.

Two practical problems, as yet undecided by the reviewing Courts, relate to the rights of a holder of a vendor's lien to reinstate a prior deed of trust or mortgage and to redeem from a prior deed of trust or mortgage.

Almost all secured promissory notes contain a provision that the holder thereof has the right to declare all sums immediately due and payable on any default under the note and/or deed of trust. Civil Code section 2924c, limits the right to accelerate full payment of the secured obligation, and provides that "the trustor or mortgagor or his successor in interest . . . or any other person having a subordinate lien or encumbrance of record" has the right to cure an existing default on payment of only the delinquent installments plus certain charges. Since the holder of a vendor's lien does not have a "subordinate lien or encumbrance of record," it could be argued that he is not entitled to reinstate a prior mortgage or deed of trust. However, since Civil Code section 2924c allows reinstatement by a junior encumbrancer "of record," this same section may allow for reinstatement by the holder of a vendor's lien if the deposit receipt or agreement of sale,

9. See Hetland, *Deficiency Judgment Limitations in California—A New Judicial Approach*, 51 Cal. L. Rev. 1 at 19–23 (1963). See also McGreevy v. Constitution Life Ins. Co., 238 Cal. App.2d 364, 47 Cal. Rptr. 711 (1965), affirming \$225,000 judgment and foreclosure of vendor's lien without mentioning section 580b bar to deficiency judgment.

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specifying therein that the vendor is taking an unsecured promissory note for a portion of the purchase price, has been recorded.

“Redemption” is the right afforded junior lien holders to protect their interests by paying the full amount secured by a prior lien, and the redemption rights are set forth in Civil Code sections 2903, 2904, and 2905. If the vendor’s lien is created at a time when a prior lien is already in existence, it appears clear that the holder of the vendor’s lien can redeem from the prior lien. However, if a vendor’s lien is not valid against a subsequent encumbrancer in good faith and for value, under the provisions of Civil Code section 3048, a question arises (and is as yet unanswered) whether the holder of a vendor’s lien has an interest in the real property (section 2903) or is the holder of a junior lien (section 2904) *as to such encumbrancer* so as to allow redemption. The above question may be raised because a senior lien holder can object to an attempted redemption by a person not holding a valid lien.¹⁰

V. Equitable Mortgages

In *James v. P.C.S. Ginning Co.*,¹¹ the plaintiffs obtained financing from the defendant, and executed a promissory note secured by a crop mortgage. As additional collateral, the plaintiffs executed security agreements and financing statements, which were, in effect, personal property mortgages covering farming equipment. Listed along with the equipment was an item that read “*Equity in House \$10,000.*” Both parties intended the equity in the home to be security for the loan. The defendant brought an action on the note as an unsecured creditor and recovered a personal judgment against

10. In *Lee v. Joseph*, 267 Cal. App. 2d 30, 72 Cal. Rptr. 471 (1968), the Court held that when a junior lien holder is seeking redemption, the senior lien holder has the defense of the junior lien holder’s lack of bona fides available to him. It is therefore arguable that under the rule of *Lee v. Joseph*, a

senior lien holder could defend redemption by a holder of a junior vendor’s lien on the basis of the invalidity of the lien.

11. 276 Cal. App.2d —, 80 Cal. Rptr. 457. For a further discussion of this case, see York, REMEDIES, in this volume.

the plaintiffs. The plaintiffs filed voluntary bankruptcy, claiming their home to be exempt by virtue of a homestead recorded after the defendant recorded its financing statements reflecting the equity in the home as security for the loan. The court held that the parties had created an equitable mortgage, and that the defendant, by recovering a personal judgment, had waived its equitable mortgage on the home under the "one form of action" provisions of Code of Civil Procedure section 726.

VI. "Due On Sale" Clauses

A "due on sale" clause, commonly found in deeds of trust, provides that the beneficiary has the option of declaring all sums secured thereby immediately due and payable on a sale or transfer of the secured property.

In *Hellbaum v. Lytton Sav. & Loan Assn.*,¹² Lytton's deed of trust expressly made applicable a prepayment fee to any early payment of the unpaid balance that the debtors might be compelled to make under a right of acceleration established by the due on sale clause. The Court held that the prepayment fee, coupled with the due on sale clause, was not an invalid restraint on alienation. In this case, the plaintiffs had a prospective purchaser offering an amount in excess of the unpaid principal obligation secured by the Lytton deed of trust. Lytton would consent to an assumption without imposing its due on sale clause only if the buyers would pay a 5% assumption fee. The buyers refused, the sale fell through, the plaintiffs then defaulted in their payments to Lytton, and a nonjudicial sale was subsequently held. Plaintiffs sued for damages in an amount equal to the difference between the unpaid balance on the Lytton loan and the amount they would have received had the sale gone through. The Court, in dictum, mentioned that if the 5% assumption fee was so large as to have no reasonable relationship to the justifiable interests of the lender, perhaps a factual question could be presented as to whether in effect the restraint was unreason-

12. 274 Cal. App.2d —, 79 Cal. Rptr. 9 (1969).

able. However, even if the proposed assumption fee was extremely large, the invalidity of the fee would, presumably, not invalidate Lytton's right to call the loan, leaving the borrower in the same position. The Court also rejected the plaintiffs' arguments of forfeiture and Lytton's alleged duty to permit assumption of its deed of trust.

*Cherry v. Home Sav. & Loan Assn.*¹³ held that there is no implied requirement that a lender act "reasonably" in exercising its option to accelerate on sale or transfer, and that the due on sale clause does not constitute an invalid restraint on alienation. This case sets forth the business reasons for a lender's use of due on sale clauses. One of the most prevalent reasons is that the clause permits acceleration on transfer, so that the lender may take advantage of rising interest rates in the event its borrower transfers the property.

VII. Subordination and Substitution Clauses

The plaintiff in *Ruth v. Lytton Sav. & Loan Assn. of Northern Cal.*,¹⁴ was the beneficial owner of real property standing in the name of defendant title company under a holding agreement. The plaintiff authorized a sale of the property in which he anticipated receiving a first deed of trust, and his instructions provided that his deed of trust could be subordinated to deeds of trust for "a construction and/or takeout loan" bearing interest of not more than 7.2% per annum, and that the amount of said loan was to be limited to a sum no greater than 66 $\frac{2}{3}$ % of the total value of both land and buildings according to appraisal of the lending institution. Lytton made a loan of \$620,000, 68.84% of appraised value, bearing interest at 6 $\frac{3}{4}$ %, with a provision that Lytton had the option to increase the interest rate by 2% on default. The downpayment of \$40,000 was paid out of the Lytton loan proceeds. The defendant title company recorded the Lytton deed of trust first and plaintiff's deed of trust second. Default was made in payment to Lytton, which then held a nonjudicial sale, wip-

13. 276 Cal. App.2d —, 81 Cal. Rptr. 135 (1969).

14. 266 Cal. App.2d 831, 72 Cal Rptr. 521 (1968); modified 272 CA2d 24, 76 Cal. Rptr. 926.

ing out plaintiff's second trust deed. The Court held Lytton was bona fide encumbrancer for value, taking without knowledge of the above subordination provision, but held the defendant title company liable for negligence in allowing the transaction to close, because (a) the "construction loan" did not include the \$40,000 downpayment, (b) the interest limitation was exceeded, and (c) the amount of the loan exceeded $66\frac{2}{3}\%$ of appraised value. The plaintiff recovered the amount of his note, interest thereon, costs, and reasonable attorneys' fees from defendant title company.

In *Connell v. Zaid*,¹⁵ the plaintiffs purchased property from the defendants' assignors in 1961, and gave them a note secured by a fourth deed of trust, which contained a subordination clause allowing the plaintiffs to subsequently refinance and consolidate the then existing first, second, and third deeds of trust, on certain conditions. In August, 1967, the plaintiffs desired to refinance the first, second, and third deeds of trust, and the defendants refused to execute a subordination agreement allowing for the new first deed of trust. The plaintiffs commenced an action for specific performance and declaratory relief. The trial court sustained a demurrer without leave to amend. The reviewing Court distinguished the clause in the present case from a conventional "subordination" agreement, stating that the conventional agreement relates to new money coming in for development and improvement of the land, whereas the clause in this case is one of refinancing with respect to encumbrances having priority from the inception of the financial arrangements. Substitution and subordination are necessarily the same in the sense that each must be founded on agreement of the parties. The reviewing court reversed the trial court, sending the matter back for trial in order that evidence could be presented as to the meaning of the "subordination" clause.

15. 268 Cal. App.2d 788, 74 Cal. Rptr. 371 (1969).

VIII. Release Clauses

The Court of Appeals, in *White Point Co. v. Herrington*,¹⁶ refused to grant specific performance of an executory contract to purchase real property, because the provisions in the contract relating to partial releases from a purchase-money deed of trust referred only to a per acre release price, without describing the acreage to be released.

A reviewing Court has for the first time considered the effect of an uncertain release clause in a deed of trust executed by the purchasers in a consummated sales transaction. In *Lawrence v. Shutt*,¹⁷ the plaintiffs purchased property from the defendants for \$1,280,000—\$250,000 in cash and a promissory note and deed of trust for \$1,030,000. The release clause in the note allowed for releases of “contiguous” acreage, and although the release clauses were not sufficiently certain for specific performance, the Court declined to invalidate the entire transaction because to do so would have created an undue hardship on the plaintiffs and because plaintiffs agreed during trial to waive the release provisions and purchase the property with the blanket deed of trust. As evidenced by *White Point Co. v. Herrington, supra*, the opposite result would have occurred if the foregoing transaction was only in an executory stage.

Subordination clauses and release clauses are important elements in the development of land. Subordination clauses allow the buyer to procure construction and take out loans for buildings and improvements to be constructed on the property without the burden of having first to pay the full purchase price in cash. Release clauses allow development on a per lot or per acre basis with the payment of a per unit amount on the purchase money note, and again, do not require that the full purchase price be paid prior to any release from the purchase-money deed of trust. The Courts, however, by imposing stringent conditions for the enforceability of subordination and release clauses, have precluded the effective use of the clauses. With respect to subordination clauses, it

¹⁶ 268 Cal. App.2d 458, 73 Cal Rptr. 885 (1968).

¹⁷ 269 Cal. App.2d 749, 75 Cal Rptr. 533 (1969).

appears that setting forth the maximum amount of the prospective first deed of trust, together with the maximum interest rate (leaving all other provisions for agreement between buyer and lender), is insufficient unless the buyer also pays a substantial part of the purchase price in cash.

The problem with definitive release clauses is that the developer, in most instances, desires to have a degree of flexibility with respect to the path of development. Also, definitive property descriptions for release clauses usually require that the property be surveyed and engineered, and as this is an expensive process, the buyer usually is not willing to undergo such expense prior to purchasing the property.

It is suggested that many problems involving subordination and release clauses in deeds of trust can be minimized or eliminated by the use of trusts in the purchase of real property. A nondeficiency, unsecured promissory note given to the seller for part of the purchase price, coupled with stringent limitations on the trustee's powers of financing and developing the purchased property, can give the buyer a greater degree of predictability with respect to his purchase, more flexibility in the mode and manner of development, and the equivalent of section 580b protection. The seller enjoys, in essence, the equivalent of a secured position.

IX. Remedies of Seller Under Land Installment Contracts

In *Gantner v. Johnson*,¹⁸ Gantner sold real property to Johnson under a land installment contract for the total purchase price of \$68,500. Johnson made payments for several years and then defaulted. Gantner commenced this action to quiet title to the property. The Court of Appeals applied the "benefit of the bargain" rule under Civil Code section 3307, as follows: Gantner had been paid principal of \$42,801.24, but his damages were \$30,500 (\$68,500 contract price less \$38,000 fair market value of the property on the date of the breach) plus damage and repair costs of \$9,705.56. The

¹⁸ 274 Cal. App.2d —, 79 Cal. Rptr. 381 (1969).
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total damages were \$40,205.65, and, as Johnson had made payments of \$42,801.24, Gantner was required to pay the defendant (Johnson) \$2,595.59.

The Court relied on *Honey v. Henry's Franchise Leasing Corp.*,¹⁹ which held that when a vendee has materially breached his contract, the vendor has an election to rescind or to enforce the contract, and if he elects to enforce it, the "benefit of the bargain" rule of Civil Code section 3307 is applicable. The Court also rejected Johnson's argument that the reasonable rental value of the property was the measure of damages to be applied where the vendor sought to quiet title against a defaulting vendee (*Behrendt v. Abraham*).²⁰ The Court merely noted that the "benefit of the bargain" rule was apparently neither raised nor answered in *Behrendt*.

In reality, the election is one of measure of damages, and not an election to rescind or enforce the contract. The vendor will, obviously, elect the measure of damages that affords him the greatest recovery. It is unfortunate that the courts do not treat land installment contracts in the same manner as mortgages and deeds of trust, in which the vendor keeps all payments made to him by the vendee, and the vendor's remedy is to either judicially foreclose or hold a trustee's sale with respect to the property.¹

Under a land installment contract, in the event of breach by the purchaser, the best that the vendor can hope for is to keep the payments previously made to him, because section 580b will preclude any deficiency judgment against the defaulting vendee.

19. 64 Cal.2d 801, 52 Cal. Rptr. 18, 415 P.2d 833 (1966).

20. 64 Cal.2d 182, 49 Cal. Rptr. 292, 410 P.2d 828 (1966).

1. It is important to note that *Honey* did not hold Code of Civ. Proc. section

726 inapplicable to a land installment contract, but only that the parties had not sought a judicial foreclosure. See Hetland, *California Real Estate Secure Transactions*, Cal. CEB Sections 3.67 through 3.80 (1970).